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It may pay to consider commercial property for next investment

When one thinks of property investors, it's inevitably around residential property and the 'buy to let' market. While this market has thrived over recent years, the 2016 Stamp Duty Land Tax changes have made investors look at other potential options. Here **Dan Evans,** principal at Cozens-Hardy LLP solicitors, and **Robert Flint,** divisional partner at Brown & Co, answer common questions about the commercial property investment market.

ROBERT FLINT

Divisional partner at Brown & Co

I don't know much about commercial property. Isn't it more complicated than letting a house?

DE From a legal perspective, letting a commercial property is slightly more complicated than a residential property.

Residential landlords often use letting agents, who may prepare the tenancy agreements. Commercial leases are generally more detailed and a solicitor's input is essential.

That being said, a commercial lease generally tends to be for a longer term (the average lease term is currently between six to seven years) and is therefore produced less frequently.

RF The basics of it aren't overly complicated.

Like residential, you need to agree terms such as the length of lease, rent, start date. However, it is important to have a qualified chartered surveyor oversee this process to ensure the best deal is brokered when it comes to the detail – such as who is responsible for repairs and maintenance, what happens at the end of the lease, when is the rent reviewed and on what basis.

Furthermore, it's important to have someone manage the process while it is with the solicitor, so that any issues are ironed out as they arise.

What additional requirements are there to let a commercial property?

DE Like the residential market, there are certain legislative requirements to comply with in order to let your commercial property.

Recent legislative changes have mean that one cannot let a commercial property with an energy performance rating of less than an E. If it falls below that, the landlord must carry out works to improve the efficiency before it can be let.

Asbestos management is also an issue in commercial property. All commercial properties must comply with legislation, which principally means having a report to show if there is any asbestos and managing the same.

RF One of the advantages of a commercial property investment is that leases are often taken on full repairing and insuring terms. From the landlord's point of view, this means that the requirements are generally less involved. For example, the structure, services (heating and lighting) and decoration are the tenant's responsibility throughout the term.

Is buying a let property better than buying a vacant property?

DE While buying a pre-let property can be advantageous due to the immediate income and no costs for dealing with a new letting, you could be inheriting a problem.

Getting a lease right is crucially important. A poorly drafted lease could not only affect the investment value of the property, but also leave you exposed.

The main areas to watch out for are:

- What are the tenant's repairing liabilities?
- Does the lease have renewal rights?
- How is the rent reviewed?
- Does the tenant have the right to terminate the lease early?
- What are the obligations on the landlord?

RF As Dan says, it can be advantageous to purchase an occupied property, however, there can also be some downsides. Often, these let investments are on long-term leases and therefore there isn't much opportunity to add value. It depends on what the investor is looking for: a) a secure, long-term income, or b) an asset management opportunity to add capital value?

For the latter, one could purchase a run down, multi-unit vacant property in a good location at a 10pc+ yield and work the asset by refurbishing the property and securing good quality tenants on new leases. This is obviously a lot more involved but substantial gains can be made.

Importantly, you need to ensure that the refurbishment stacks up and is worth it in the first place. This strategy is more risky, but as the saying goes… without risk there is no reward.

Retail property is experiencing a well-documented downturn, but there are some great opportunities in other commercial properties, such as industrial units. Picture: GETTY IMAGES

The high street is full of empty shops, with established tenants going out of business. Is commercial property more risky?

RF Well, the answer here is yes and no! It is very important to do your research and ensure that the covenant strength of the tenant aligns with your risk profile. Typically, the riskier the tenant (in terms of strength of trading history, profit/loss and balance sheets), the higher the potential returns. Returns can range from 5-6pc (for a well-let Tesco investment) to 12pc+ (for a mixed-use office/retail investment on short term leases).

Asset class is also important. Retail property is experiencing a well-documented downturn. However, there are some great opportunities available to investors if considering other properties, such as industrial units.

It is important to have someone with the expertise to advise you on any potential commercial property purchase to ensure you are not overpaying.

DE As explained by Robert, covenant strength is an important consideration.

I would strongly advocate additional security in any commercial letting. A rent deposit or additional guarantors can give you protection should your tenant struggle.

That being said, it is a fine balance between having sufficient security and not making it impossible for a tenant – for example, too high a rent deposit could affect a tenant's cash flow and ability to trade successfully.